DIRECT TESTIMONY OF

ELLEN LAPSON

ON BEHALF OF

SOUTH CAROLINA ELECTRIC & GAS COMPANY

DOCKET NOS. 2017-207-E AND 2017-305-E

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Ellen Lapson and my business address is 370 Riverside Drive, New York, New York 10025.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am the founder and principal of Lapson Advisory, a private company that is a division of Trade Resources Analytics, LLC.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL QUALIFICATIONS.

A. After graduating from Barnard College of Columbia University in 1969 with a Bachelor of Arts degree, I earned a Master's degree in Business Administration from New York University's Stern School of Business in Accounting with a minor concentration in Finance. I am qualified as a Chartered Financial Analyst ("CFA") and a member of the CFA Institute.

I began my career in the financial markets as an equity analyst for five years at Argus Research Corporation analyzing utility company equity securities. For the next 20 years, I held several posts at Chemical Bank and Chemical Securities (now J.P. Morgan) as a corporate banker and an investment banker structuring and executing financial transactions for utility and infrastructure companies. Thereafter, I spent 17 years first as a senior director and then as a managing director at Fitch Ratings ("Fitch"), a major credit rating agency. At Fitch, I managed analysts who rated credits in the sectors of electricity and natural gas and project finance, and I maintained liaison with bankers and investors in utility securities. During my 37 years as a utility banker and as a utility credit rater at Fitch, I gained deep experience in dealing with utilities in various degrees of financial health and financial distress, and in those roles, I had to evaluate serious issues involving utilities' solvency, bankruptcy, and restructuring.

I founded Lapson Advisory in 2012 in order to provide consulting services on matters that involve utility finance including: credit rating advisory to utilities and infrastructure projects; advanced training for mid-career professionals in utility finance; and expert testimony on financial and credit rating issues specifically related to utilities. I provide independent consulting services relating to the financial strength of utilities and infrastructure companies. I also advise client companies on access to capital and debt markets and frequently testify as an expert witness relating to utility finance and utility capital market matters. Also, I develop and teach executive seminars about utility investment analysis, credit evaluation, and corporate finance.

Q. ARE YOU THE SAME ELLEN LAPSON WHO PREVIOUSLY FILED DIRECT TESTIMONY IN DOCKET NO. 2017-370-E?

A. Yes. On August 2, 2018, South Carolina Electric & Gas Company ("SCE&G" or the "Company") and Dominion Energy, Inc. ("Dominion Energy") (together, the "Joint Applicants") filed on my behalf 44 pages of direct testimony and 7 exhibits in Docket No. 2017-370-E. Therein, I provided information to the Public Service Commission of South Carolina (the "Commission") as an expert financial witness on behalf of the Joint Applicants regarding their Joint Application for review and approval of a business combination and a prudency determination regarding the abandonment of construction of V.C. Summer Units 2 & 3 ("Units"). My direct testimony in that proceeding discusses the weakened financial condition of SCE&G and SCANA Corporation ("SCANA"), which poses a significant risk to customers, absent the proposed business combination. My testimony also addresses the financial capability and stability of Dominion Energy as well as the benefits to SCE&G customers of the proposed business combination of SCANA into Dominion Energy. I also review the financial consequences of some alternative courses of action.

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN DOCKET NOS. 2017-207-E AND 2017-305-E?

A. The purpose of my Direct Testimony in these two dockets is to provide information and my expert opinion regarding the financial consequences that may result if the Commission were to grant the request filed by the Friends of the Earth and the Sierra Club (collectively, "FOE") in Docket No. 2017-207-E ("FOE Request") or the request filed by the South Carolina Office of Regulatory Staff ("ORS") in Docket No. 2017-305-E ("ORS Request"). I also will provide information and my expert opinion regarding the impact upon SCE&G and SCANA if the FOE Request or the ORS Request is granted or if the temporary reduction in SCE&G's rates, which was imposed pursuant to South Carolina Act No. 258 of 2018 ("Act 258") and by way of Order Nos. 2018-459 and 2018-460, are made permanent. I also adopt and incorporate my direct testimony and exhibits filed in Docket No. 2017-370-E. In addition, I update and supplement that testimony to discuss events that have occurred since it was filed.

Q. DOES YOUR DIRECT TESTIMONY FILED IN DOCKET NO. 2017-370-E DISCUSS ISSUES THAT RELATE TO YOUR OPINIONS IN THIS MATTER?

A. Yes. As discussed therein, SCE&G and its parent SCANA currently are in a weakened financial condition as demonstrated by the diminished value of SCANA's shares, reduced investor willingness to purchase the commercial paper notes of South Carolina Fuel Company, recent downgrades of SCE&G's and SCANA's credit ratings, and the fact that both companies' credit ratings are on a rating watch status for likely further downgrades. The financial future of both SCE&G and SCANA is clouded with uncertainty, and as a consequence, the companies are constrained in their access to equity and debt capital funding, creating additional risk for utility customers. These same issues pertain to the FOE

Request and the ORS Request and their impact upon SCE&G and SCANA. Accordingly, I adopt and incorporate herein by reference my direct testimony and exhibits filed in Docket No. 2017-370-E and have attached a copy thereof to this testimony as Appendix A. The remainder of my Direct Testimony in these two dockets supplements and updates this prior testimony.

Q. HAVE YOU REVIEWED THE TESTIMONY FILED BY FOE AND ORS IN DOCKET NOS. 2017-207-E, 2017-305-E, AND 2017-370-E?

A. Yes.

Q. DOES THE TESTIMONY FILED BY EITHER FOE OR ORS CAUSE YOU TO RECONSIDER OR REVISE THE TESTIMONY YOU FILED IN DOCKET NO. 2017-370-E?

A. No. My previously filed testimony remains true and correct, in conjunction with the updates provided herein.

Q. HAVE ANY SIGNIFICANT EVENTS OCCURRED SINCE THE TIME YOUR DIRECT TESTIMONY WAS FILED IN DOCKET NO. 2017-370-E?

A. Yes. On August 8, 2018, Fitch downgraded the long-term credit ratings of SCE&G from BBB- to BB+ and of SCANA from BB+ to BB. The next day, on August 9, 2018, Standard & Poor's Corporation ("S&P") also announced a credit downgrade of SCANA and SCE&G from BBB to BBB–. Copies of the public releases issued by Fitch and S&P regarding the downgrades are attached to my Direct Testimony as Exhibits __ (EL-1) and __ (EL-2), respectively.

My direct testimony in Docket No. 2017-370-E, which is adopted and incorporated herein, included Tables 2 and 3 that showed the credit ratings of SCE&G and SCANA in January 2017 and at subsequent dates through July 2018. Tables 1 and 2 below update those two tables, showing the credit ratings and outlooks from each agency up to the date of this submission, and incorporate the rating downgrades announced by Fitch and S&P on August 8 and 9.

Table 1: South Carolina Gas & Electric Credit Ratings & Outlook Status

Rating Agency	**Jan. 2017**	**Nov. 1 2017**	**Feb. 5 2018**	**July 3 2018**	**Current Rating**
Fitch	BBB (Neg. Watch)	BBB– (Neg. Watch) 09/29/17	BBB– (Evolving Watch) 01/03/18	BBB– (Evolving Watch) 07/03/18	BB+ (Evolving Watch) 08/08/18
S&P	BBB+ (Outlook Stable)	BBB (Watch Neg.) 09/29/17	BBB (Watch Neg.) 09/29/17	BBB (Watch Neg.) 07/03/18	BBB– (Watch Neg.) 08/09/18
Moody's	Baa2 (Outlook Neg.)	Baa2 (On Review for Downgrade 11/01/17	Baa3 (On Review for Downgrade) 02/05/18	Baa3 Outlook Neg. 07/03/18	Baa3 Outlook Neg. 07/03/18

Table 2: SCANA Credit Ratings & Outlook Status

Rating Agency	**Jan. 2017**	**Nov. 1 2017**	**Feb. 5 2018**	**July 3 2018**	**Current Rating**
Fitch	BBB– (Neg. Watch)	BB+ (Neg. Watch) 09/29/17	BB+ (Evolving Watch) 01/03/18	BB+ (Evolving Watch) 07/03/18	BB (Evolving Watch) 08/08/18
S&P	BBB+ (Outlook Stable)	BBB (Watch Neg.) 09/29/17	BBB (Watch Neg.) 09/29/17	BBB (Watch Neg.) 07/03/18	BBB– (Watch Neg.) 08/09/18
Moody's	Baa3 (Outlook Neg.)	Baa3 (On Review for Downgrade 11/01/17	Ba1 (On Review for Downgrade) 02/05/18	Ba1 Outlook Neg. 07/03/18	Ba1 Outlook Neg. 07/03/18

Q. WHAT REASONS DID FITCH AND S&P GIVE FOR DOWNGRADING THE CREDIT RATINGS?

A. Among other things, Fitch explained that it downgraded SCE&G and SCANA following “the absence of injunctive relief blocking the recently enacted 14.8% electric rate cut,” which was imposed by the Commission in Order Nos. 2018-459 and 2018-460 pursuant to Act 258. Fitch also stated that, “[i]f allowed to stand, Fitch considers the magnitude of the cut to be detrimental to SCE&G’s and [SCANA’s] credit metrics, even after consideration of [SCANA’s] 80% reduction of the common dividend.” Exhibit __ (EL-1) at 1.

S&P gave similar reasons for its downgrade stating, among other things, that “[t]he rating actions follow the Aug. 6, 2018 federal court denial of SCE&G’s request for a preliminary injunction to halt a temporary 15% rate reduction tied to V.C. Summer cost recovery.” Exhibit __ (EL-2) at 3. S&P further stated that “[t]he downgrade on SCANA and its subsidiaries reflects [its] expectation of reduced consolidated credit metrics over the next two years, even after incorporating the company’s announced cut to its dividend payments.” *Id.*

Q. DID FITCH OR S&P GIVE ANY INDICATION WHETHER THE OUTCOME OF THE PROCEEDINGS BEFORE THE COMMISSION COULD FURTHER IMPACT SCE&G’S AND SCANA’S CREDIT RATINGS?

A. Yes. Fitch made clear that, if the temporary rate cuts imposed by Order Nos. 2018-459 and 2018-460 were made permanent, it is likely that Fitch would downgrade SCE&G's and SCANA's credit ratings even further.[1] Specifically, Fitch expressed concern about the outcome of these proceedings, stating "that the expected December order [to be issued by the Commission] could be of the same magnitude" as the temporary rate reduction required by Act 258. Exhibit __ (EL-1) at 1. Fitch also stated that "[i]f the PSC issues an order in December 2018 with a permanent cut of a similar magnitude, additional downgrades may be warranted."

S&P maintains the ratings of SCE&G and SCANA on Credit Watch Negative, which S&P attributes to continuing uncertainty regarding the outcome of these proceedings. S&P stated that it "anticipate[s] a weakening of the consolidated company's credit measures … if the temporary 15% reduction is made permanent." Explaining its Credit Watch status, S&P further commented:

> We could lower ratings again if credit metrics weaken further beyond those in our base-case scenario, which assumes the temporary rate cut is made permanent. This could occur following the pending Summer abandonment proceeding if the PSC orders a permanent rate reduction or rate credits that lead to incrementally weaker financial measures than those resulting from the temporary 15% rate cut.

(Exhibit __ (EL-2) at 3).

[1] Fitch's ratings of SCANA and SCE&G are on an alert status classified as "Evolving Watch." As discussed in my direct testimony filed in Docket No. 2017-370-E, "Evolving Watch" is an infrequent designation that signals a circumstance in which one likely outcome is negative (action by the South Carolina Legislature or the Commission that would cause a termination of the Agreement and Plan of Merger) and would lead the agency to lower the rating, while another outcome (regulatory approval and closing of the proposed business combination) would lead Fitch to raise the rating. Like a Negative Watch, an Evolving Watch signifies that the situation is unstable, and also carries a material likelihood of a downgrade.

Q. A THIRD RATING AGENCY, MOODY'S INVESTORS SERVICE ("MOODY'S"), DID NOT DOWNGRADE SCE&G OR SCANA IN AUGUST 2018 WHEN S&P AND FITCH DID SO. WHAT RESPONSE FROM MOODY'S DO YOU EXPECT IF THE COMMISSION WERE TO GRANT THE FOE REQUEST OR THE ORS REQUEST?

A. Moody's gave a clear signal in the Ratings Action comment it published on July 2, 2018 that a further downgrade is likely under any one of several outcomes relating to the current proceedings. *See* Exhibit __ (EL-3). Moody's commentary stated:

> Factors that could lead to a downgrade
>
> Downward pressure on the ratings could again increase if SCE&G is ordered to refund amounts previously collected under the BLRA, particularly without the benefit of a larger, better capitalized partner; or if rates established by the SCPSC later this year do not provide an opportunity for SCE&G to maintain a ratio of CFO pre-WC to debt that is at least in the low-teens on a sustained basis. Furthermore, if the company's liquidity becomes constrained, such as being unable to draw on its credit lines or to issue additional debt, there could also be downward movement in the ratings.

(Exhibit __ (EL-3) at 2). Thus, I do not interpret Moody's decision not to lower its ratings in August as an indication of complacency on the part of Moody's. Granting the FOE Request or the ORS Request would result in at least one or perhaps several of the conditions that Moody's lists as triggers for a further downgrade. My understanding of the Moody's text cited and Moody's negative rating outlook for SCE&G and SCANA is that Moody's would lower SCE&G'S

issuer rating to speculative ratings from Baa3 if the FOE Request or the ORS Request is granted.

Q. WHAT DO THESE STATEMENTS SUGGEST WITH RESPECT TO THESE PROCEEDINGS?

A These statements make clear that the financial markets are closely watching the matters concerning SCE&G that are pending before the Commission—namely, the proceedings in Docket Nos. 2017-207-E, 2017-305-E, and 2017-370-E—and have concerns about the impact of the proceedings on the companies' creditworthiness and financial integrity.

Q. WHAT ARE SOME REASONS THAT GRANTING THE FOE REQUEST OR THE ORS REQUEST WOULD LEAD TO FURTHER DOWNGRADES IN SCE&G'S AND SCANA'S CREDIT RATINGS?

A. Granting the relief requested by either FOE or ORS would deprive SCE&G of a major portion of its needed cash flow resulting in an additional asset write-down and a serious reduction of the Company's common equity. All three of the credit rating agencies that rate SCE&G put considerable weight upon measures of debt leverage that relate a measure of cash flow with the total amount of debt and debt-like obligations. The reduction in cash flow that would result from the elimination of all or most of the revenues from BLRA would cause a material increase in SCE&G's debt leverage as measured by credit rating agencies. SCE&G would most probably be deemed to be "highly leveraged," resulting in sub-investment grade ratings.

Implementing the FOE Request or the ORS Request also would cause asset write-downs that would result in reductions in the common equity account; that in turn would likely cause SCE&G to reach a debt leverage ratio measured by total debt to total capital either near or exceeding the debt limit covenant in SCE&G's credit agreements. That would produce a likely constraint on, or loss of, corporate liquidity. The resulting financial stress would not be beneficial to customers and could undermine SCE&G's ability to satisfy the needs of its customers for safe and reliable utility services.

Q. PLEASE EXPLAIN HOW THE REDUCTION IN COMMON EQUITY COULD CAUSE SCE&G TO VIOLATE THE DEBT LEVERAGE COVENANT IN ITS REVOLVING CREDIT FACILITY, AND WHAT WOULD BE THE FINANCIAL IMPLICATIONS IF THAT OCCURS.

A. A permanent elimination of BLRA revenues would result in the write-down of SCE&G's assets and a resultant reduction in common equity. The value of SCE&G's debt would not be reduced. Thus, the ratio of debt to total capital as measured in the financial covenants of SCE&G's revolving credit facilities would reach or exceed the 70% debt limitation that is defined as a covenant default. In that case, all of SCE&G's loans would become immediately due and payable, triggering a liquidity crisis.

But even in a less extreme scenario, in which SCE&G did not breach the covenant level of 70% debt-to-capital, but approached the threshold, its debt would exceed 60% of total capital, and SCE&G would be deemed in the financial markets to be “highly leveraged.” Potential lenders and bond buyers would consider SCE&G to be at an elevated risk of future covenant defaults without sufficient financial flexibility to weather any operating stresses. The limited financial flexibility and reduced access to sources of liquidity would result in speculative grade credit ratings, if the ratings had not already been reduced to speculative grade. Furthermore, if the FOE Request or the ORS Request is granted, it is questionable whether the Company would have access to draw down its credit facility to offset inadequate operating cash flow. Under this circumstance, SCE&G’s ability to repay those loans would be significantly impaired

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.